

**JOINT TESTIMONY PRESENTED TO THE FINANCE, REVENUE, AND
BONDING COMMITTEE AND THE COMMERCE COMMITTEE**

March 10, 2014

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Development*

Testimony Supporting House Bill No. 5465

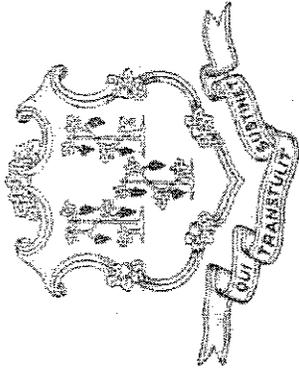
AN ACT CONCERNING THE CONNECTICUT AEROSPACE REINVESTMENT ACT

Senator Fonfara, Senator LeBeau, Representative Widlitz, Representative Perone and distinguished members of the Commerce and Finance, Revenue, and Bonding Committees, thank you for the opportunity to offer testimony on House Bill No. 5465, An Act Concerning The Connecticut Aerospace Reinvestment Act. We strongly support this legislation and urge you to do the same.

This bill establishes a process by which taxpayers that are primarily engaged in the industrial sector may apply to the Commissioner of Economic and Community Development for certification of certain projects they intend to undertake in Connecticut as state certified industrial reinvestment projects. The bill authorizes the Commissioner to enter into a contract with eligible taxpayers in order to incentivize economic development and capital investment in Connecticut. To facilitate an agreement, the Commissioner is authorized to agree to an exchange of unused research and development (R&D) tax credits. In order to qualify for this incentive, projects must, in the discretion of the Commissioner, be consistent with the strategic economic development priorities of the state.

This legislation will enable the Commissioner to implement an agreement reached between Governor Malloy's administration and United Technologies Corporation (UTC). As a result of this deal, UTC will make \$500 million in capital investments in Connecticut over 5 years. These investments will ensure that the state's largest private employer maintains its presence in Connecticut in future years. This testimony is accompanied by a PowerPoint presentation, which will provide specifics of the agreement in principle between UTC and the State.

We would like to again thank the committees for the opportunity to present this testimony. We respectfully request that the committees support this bill, and we will be happy to answer any questions you may have.



State of Connecticut

House Bill No. 5465

AAC The Connecticut Aerospace Reinvestment Act

**Presentation before the
Finance and Commerce Committees**

**Catherine Smith, Commissioner, DECD
Ben Barnes, Secretary, OPM**

March 10, 2014



Introduction

Why are we here today?

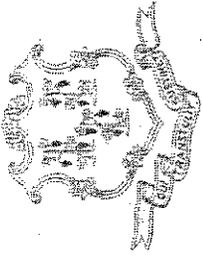
1. Testimony in support of the bill before you
2. Provide pertinent background information
3. Explain the agreement
 - Details
 - Facilities/Construction
 - Investment
 - Potential State Costs
 - “Earning” Tax Offsets
 - Economic Impact
 - Comparison
4. Conclusion



Background

Research & Development Tax Credits in Connecticut

- Originally enacted in 1993
- Credit worth 1% to 6% of research and development (R&D) expenses
- Taken against the corporation tax
- Credits against the corporation tax may be used to reduce a taxpayer's liability by up to 70%
- Unused credits may be carried forward to future years at full value
- At the end of FY 2013:
 - \$4.8 million in R&D credits claimed
 - The majority of these were claimed in the manufacturing sector
 - There were \$1.4 billion in unclaimed R&D tax credits



Background

Why is UTC important to Connecticut?

A long history with Connecticut:

- Pratt & Whitney founded in 1925
- Sikorsky moved to Stratford in 1929

United Technologies Corporation (UTC) is one of sixteen Fortune 500 companies headquartered in Connecticut. It ranks 50th in the nation based on revenues.

UTC is the largest private employer in Connecticut¹

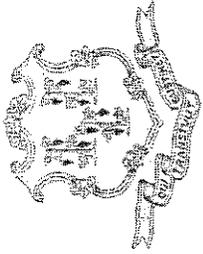
Together with the substantial supply chain that has developed, Connecticut's experienced workforce, and UTC's presence, Connecticut is a global aerospace hub:

- Connecticut is 6th in number of aerospace jobs²
- Connecticut is 2nd in aerospace jobs per capita³

¹ Hartford Business Journal - 2013 Book of Lists

² UTC, *Powering the Future of Connecticut Aerospace*, February 2014, page 6.

³ *Ibid*, page 6.



Background

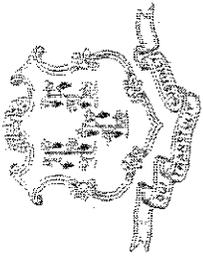
Why is UTC important to Connecticut? (cont.)

Suppliers:

- UTC has nearly 2,500 direct suppliers across Connecticut, 700 of whom have provided more than \$100,000 in goods or services to UTC over the past year
- UTC suppliers come from all 169 towns in Connecticut



Note: Map displays the 700 major suppliers providing more than \$100,000 in goods and services to UTC



Background

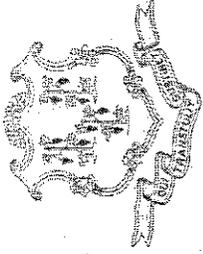
Why is UTC important to Connecticut? (cont.)

Exports and Employment:

- Transportation Equipment (including aerospace) with employment of about 41,000, is the largest sector for manufacturing employment in Connecticut
- In FY 2012, Transportation Equipment accounted for 45.2% of Connecticut's total exports of \$16 billion – more than 3 times the next largest sector
- UTC makes up about half of the Transportation Equipment sector's employment

Defense:

- Defense contract awards made up 5.2% of the state's GSP in Federal Fiscal Year (FFY) 2012
- Connecticut ranked 7th among all states in defense contract awards at \$12.7 billion in FFY 2012
- Connecticut ranked 2nd in Per Capita Defense Contracts awards in FFY 2012
- UTC is Connecticut's largest defense contractor



The Agreement UTC Requirements

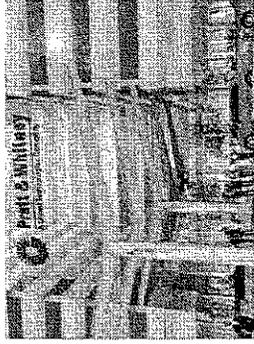
United Technologies Corporation (UTC) will:

- Make investments of \$500 million over 5 years (\$375 million at P&W/UTAS/UTRC, \$125 million at Sikorsky)
- Invest billions more in aerospace research and development in Connecticut and maintain strong levels of employment in the state
- Maintain and operate Pratt & Whitney division headquarters in Connecticut for at least 15 years after completion of construction
- Maintain and operate United Technologies Research Center and Aerospace Systems facilities in Connecticut for at least 10 years after completion of construction
- Maintain and operate Sikorsky headquarters in Connecticut for at least 5 years

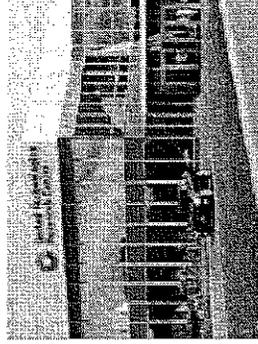


The Agreement Facilities/Construction (2014 – 2018)

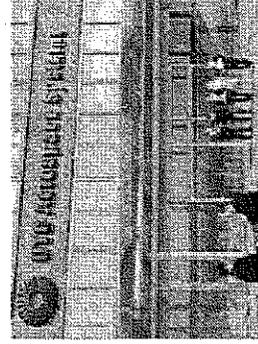
New Pratt & Whitney 425,000 square-foot World Headquarters and Engineering facility in East Hartford – A collaboration hub for manufacturing facilities worldwide – Replacing structures from the 1930's and 1962



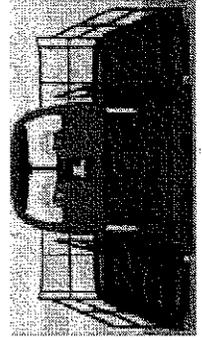
The upgrade and expansion of 100,000 square feet of UTC research and engineering labs in East Hartford – for research in advanced product and manufacturing technologies and to enable collaboration with university researchers – Renovating/expanding facilities built from 1943 - 1986

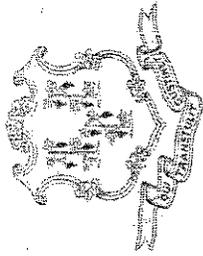


New engineering labs and a 12,000 square-foot global customer training center at the UTC Aerospace Systems facility in Windsor Locks, replacing the original from the early 1960's



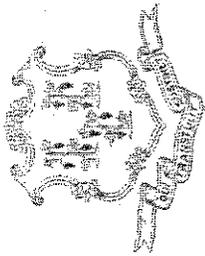
Significant capital investments at the Sikorsky facility in Stratford, including improvements to engineering and design labs and upgrades to manufacturing facilities





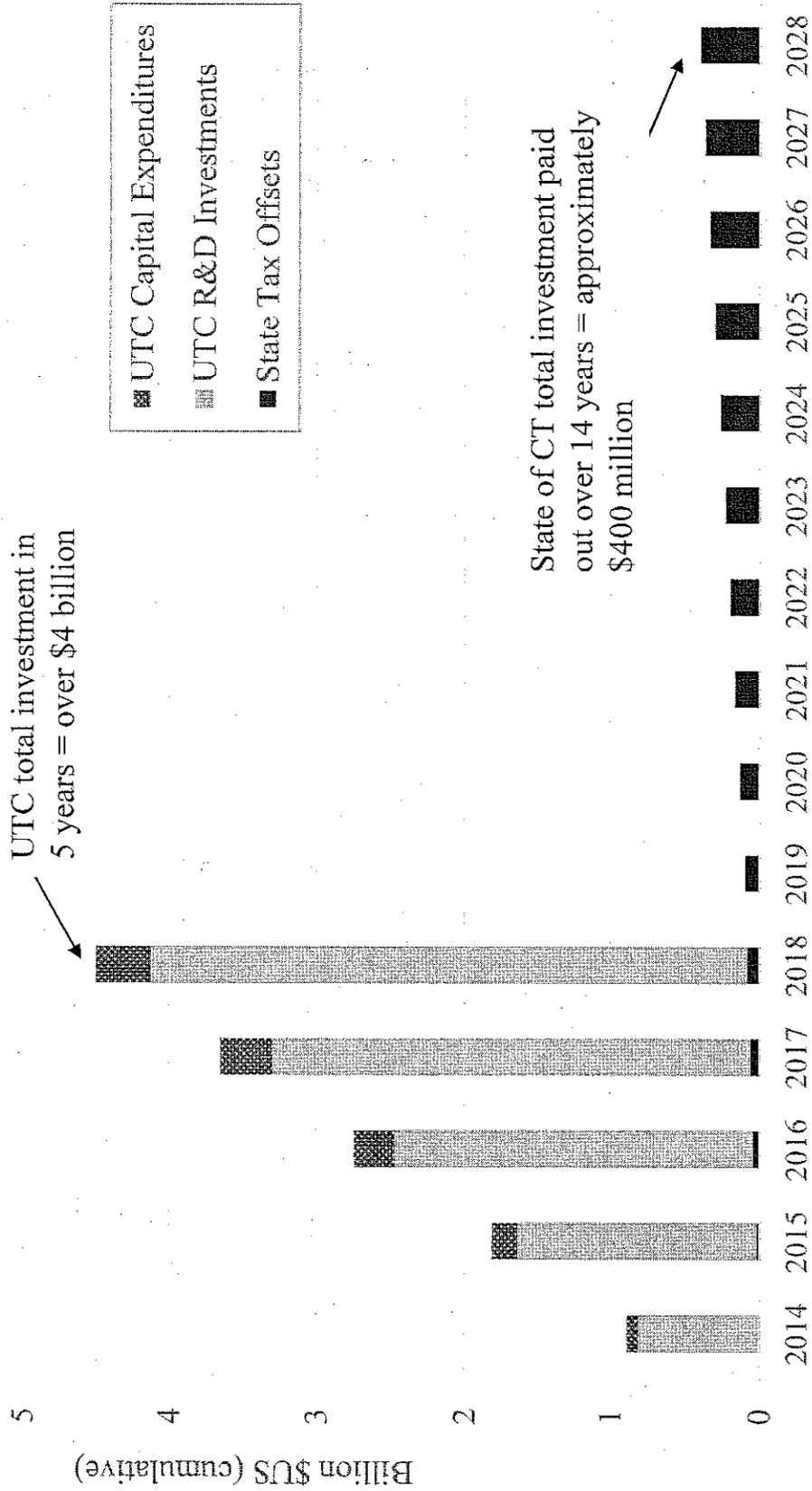
The Agreement State Requirements

- State will allow UTC to exchange previously earned R&D tax credits to offset future sales and corporate tax obligations, not to exceed \$400 million
- Agreement requires no state bonding or appropriations
- State will spread tax offsets over 14 years, with a maximum of \$20 million in offsets per year for the first 5 years
- Agreement provides a claw back provision if company fails to meet required terms
- State will measure company performance over the next 5 years against certain key metrics to determine final benefit to the company

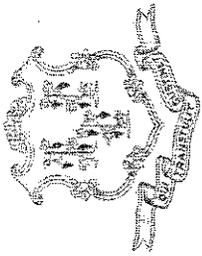


The Agreement

Expected Cumulative UTC and Connecticut Investments

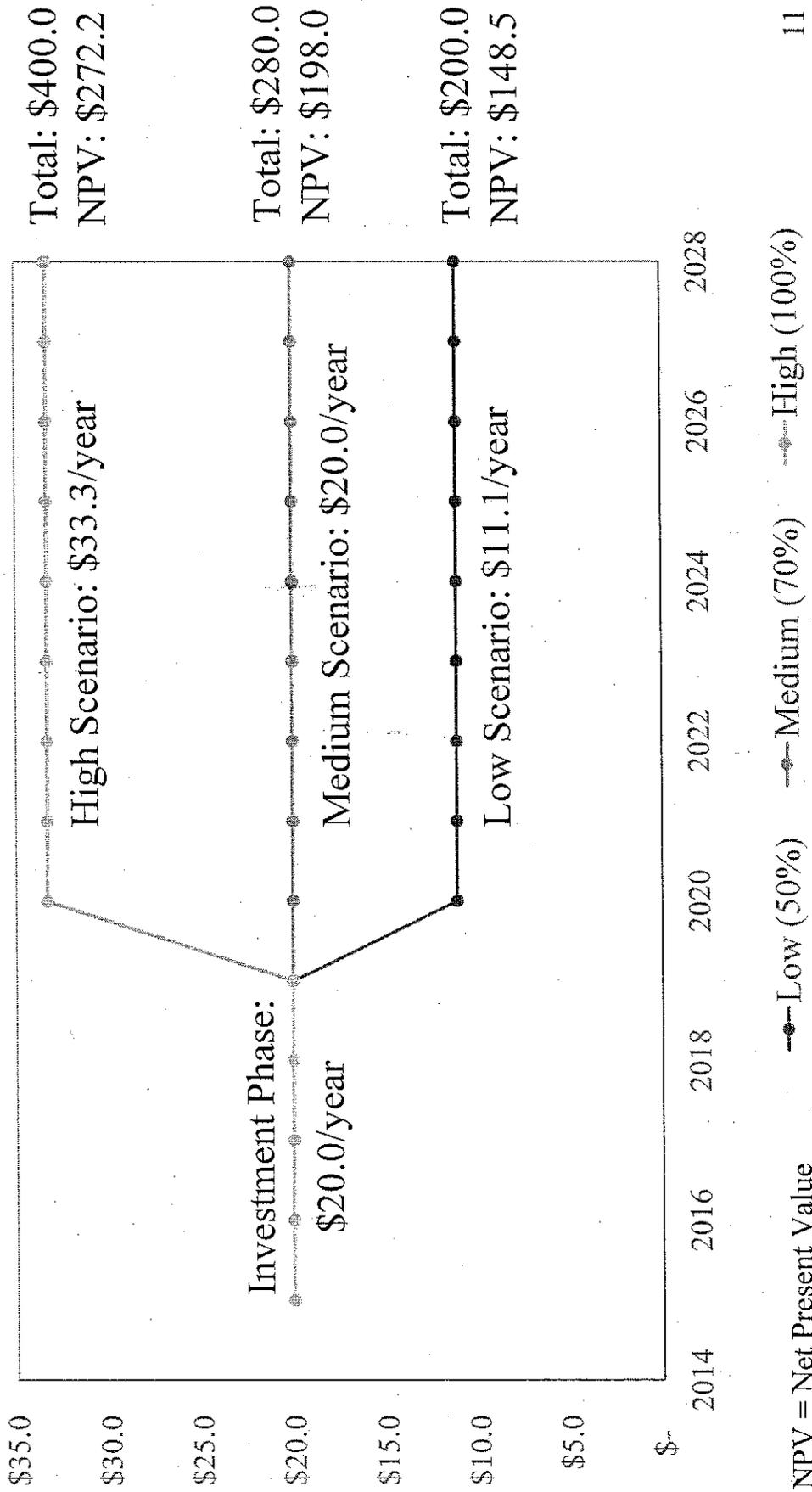


Assumes company performs at the 100% funding level



Future State Costs Depend on UTC Performance

Potential State Costs: FY 2015 – FY 2028 (in millions)



NPV = Net Present Value
Calculated at 5%

---●--- Low (50%) —●— Medium (70%) - - -●- - - High (100%)



The Agreement - How is it calculated? P&W/UTRC/UTAS Must "Earn" its Tax Offset

Total Tax Offsets will be calculated based on activities during the first five years (2014-2018), including:

- (1) Actual investments made by UTC (estimated Target Spend)
- (2) Four factors, which include Engineering Headcount, Total Headcount, Gross Payroll, and R&D / Capital expenditure investments

The dollar amount of the exchange/offset, to be paid out over 14 years, will be calculated based on the actual annual investment (Target Spend) multiplied by the weighting and level of each factor

Target Spend by UTC	
	(\$ Millions)
Year 1	80
Year 2	100
Year 3	100
Year 4	75
Year 5	20
	375

Years 1 to 5					
Engineering Headcount Weighting	Total Headcount Weighting	Gross Payroll (\$M) Weighting	R&D / Capex (\$M) Weighting		
Below 4,350	0%	Below 1,370	0%	Below 680	0%
4,350	35%	1,370	35%	680	35%
4,500	50%	1,415	50%	710	50%
4,700	70%	1,475	70%	750	70%
5,000	100%	1,565	100%	810	100%

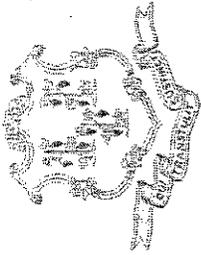
Note: The above table has been truncated for display purposes.



The Agreement – How is it calculated?

Sikorsky Must “Earn” its Tax Offset

- Should Sikorsky invest \$125 million over the next five years, the State will exchange up to \$50 million in tax credits
- Credit exchanges determined based on two part formula:
 - \$1 million for new R&D projects in Connecticut over \$10 million that retain 100 or more employees
 - 40% for capital expenditure projects within Connecticut over \$1 million



The Agreement – Overall Economic Impact

Impact on Connecticut's Economy and Jobs

Impact Over 15 Years (2014 - 2028)*

	Direct Jobs	Indirect and Induced Jobs	CT GDP (\$M)	Net State Revenues (\$M)
NO AGREEMENT	-5,700	-2,800	-\$1,202.6	-\$74.8
AGREEMENT	+300	+900	\$104.8	\$6.5

* Average over the 15 year period

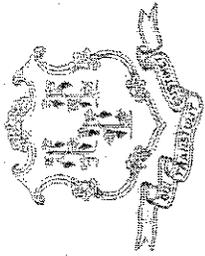
No Agreement assumes:

- Declining engineering and total employees (-7% per year for the first 10 years) as UTC builds new facilities in other parts of the world
- Associated downward adjustments in R&D expenditures

Agreement assumes:

- UTC achieves 100% of the available tax credit exchanges
- Net State Revenues include the negative impact of \$400 million of tax offsets
- Engineering and total headcounts, Gross Payroll, and R&D/Capex are held flat at the 100% funding level over analysis period

Source: DECD



The Agreement – Construction Impact

Impact on Connecticut’s Economy and Jobs

Construction of the new headquarters and other facilities is, by itself, a major economic stimulus.

Impact of the \$375 Million Investment* Over 5 years (2014 - 2018)

Jobs	Indirect and Induced Jobs	CT GDP (\$M)	Net State Revenues (\$M)
+563	+347	\$62	\$9

* Average over the 5 year period

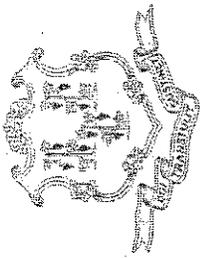
- Construction jobs peak in year two with 847 jobs, then decline as buildings are completed.
- Indirect jobs (those created by the overall activity of the construction) start at 750, declining with the completion of construction.

The impact of construction only with no other activities or incentives
Source: DECD



The Agreement State's Commitment Compares Favorably

<u>Connecticut/UTC deal</u> <u>(\$400 Million)</u>	<u>Washington/Boeing offer</u> <u>(\$8.7 Billion)</u>
<ul style="list-style-type: none">• UTC may exchange up to \$400 million in previously earned tax credits over the next 14 years but must "earn" that level by retaining/growing jobs, payroll and investments	<ul style="list-style-type: none">• Over next 25 years, Washington state would provide:<ul style="list-style-type: none">– \$4.2 billion in business and occupation tax relief– \$3.5 billion in tax credits– \$563 million of property tax credits– \$242 million sales tax exemption



Conclusion

What does this agreement offer Connecticut?

Short Term

- Construction jobs – immediate, next 5 years
- Substantial investments from UTC in building a deep research and manufacturing capability helps tie them to the state in the future

Long Term

Direct Impact:

- State of the art facilities located in Connecticut
 - Some current facilities have been in use since the Depression or dawn of the jet age
- Job retention/potential for expansion
 - Demand for technical, highly skilled and highly compensated workers
- Retain and grow the Supplier network
- Support the State's exportable goods and services sector



Conclusion

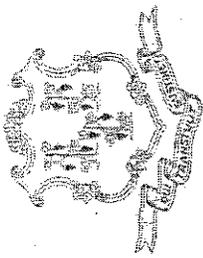
What does this agreement offer Connecticut? (cont.)

Long Term

Indirect Impact:

- Connecticut can partake in the projected rising commercial aerospace demand, and bridge the gap left by anticipated slowing in defense spending
- STEM initiatives tie-in with State colleges and universities
- Decision-makers located in Connecticut via Headquarters requirement
- Perception about Connecticut as a place to do business
 - Strong vote of confidence from largest employer in the state

❖ Potential to extend this concept to other companies in the future as well



Conclusion

Foundation for the Future

Real reason we are here today is about the future

- **Right place**
 - The tasks before the company offer challenging and rewarding work for our citizens
 - Connecticut's citizens are highly productive, with output per worker more than 33% above the national average
 - Leverage existing knowledge, skills, and facilities that is not easy to replicate
 - There is a strong need for facilities that will retain and attract the best and brightest to our state
- **Right time**
 - UTC is looking to hire workers to address expected wave of retirements over the next decade
 - Company officials are optimistic about the commercial aviation market in general and their specific product lines within that market
 - Foresee increased demand from developing countries due to rising living standards

The People of Connecticut have an Opportunity to Share in this Prosperity 19